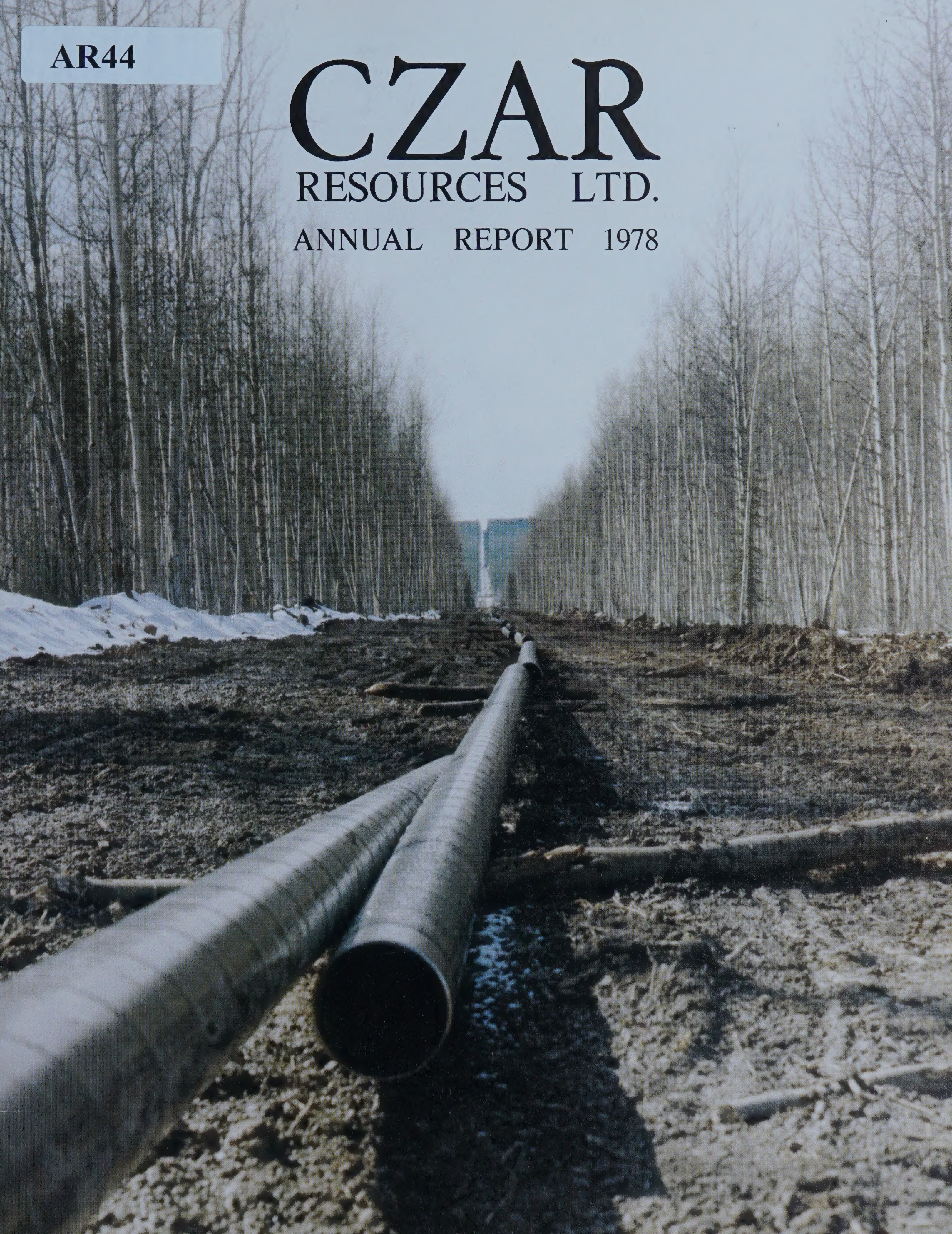
CZAR
RESOURCES LTD.
ANNUAL REPORT 1978



Board of Directors

Robert W. Lamond
Calgary, Alberta

Gregory S. Fletcher
Calgary, Alberta

Ian B. McMurtrie
Calgary, Alberta

Rudolf Siegert
Munich, West Germany

Officers

Robert W. Lamond
President & Chief
Executive Officer

Gregory S. Fletcher
Executive
Vice-President

Bonnie O. Rawlyck
Controller

Allan R. Twa
Corporate Secretary

Key Personnel

D. Harvey Bickell
Chief Engineer

Ian B. McMurtrie
Exploration Manager

Anna K. Wallace
Administrative Manager

Leslie J. Broker
Manager
Czar Resources, Inc.

P. Kimberly Swyden
Chief Landman
Czar Resources, Inc.

Head Office

10th Floor, 333 -5th Avenue South West
Calgary, Alberta T2P 3B6

U. S. Office

2520 One Allen Center
Houston, Texas 77002

Field Office

10142 - 100th Avenue
Fort St. John, British Columbia

Legal Counsel

Burnet, Duckworth & Palmer
800, Royal Bank Building
335 - 8th Avenue South West
Calgary, Alberta

Auditors

Thorne Riddell & Co.
1400, Bow Valley Square 2
205 - 5th Avenue South West
Calgary, Alberta

Registrar & Transfer Agents

The Canada Trust Company
239 - 8th Avenue South West
Calgary, Alberta

Wholly-Owned Subsidiaries

Czar Resources, Inc.
Czar Developments Ltd.

Stock Listing

The Toronto Stock Exchange
234 Bay Street
Toronto, Ontario

The Alberta Stock Exchange
201, 500 - 4th Avenue South West
Calgary, Alberta
Trading Symbol - CZR

ANNUAL MEETING

The Annual Meeting of Shareholders of Czar Resources Ltd. will be held at 2:30 p.m., Thursday, March 29, 1979, in the Marquis Room of the Palliser Hotel, 110 - 9th Avenue South East, Calgary, Alberta.

COVER PHOTO

The cover photo shows pipe strung along the right-of-way leading to the Monias gas field in north-east British Columbia. The 22 mile long Monias pipeline has been the largest construction project undertaken by the Company to date and illustrates one aspect of an exploration and development company's activities.

CZAR
RESOURCES LTD.

HIGHLIGHTS OF 1978

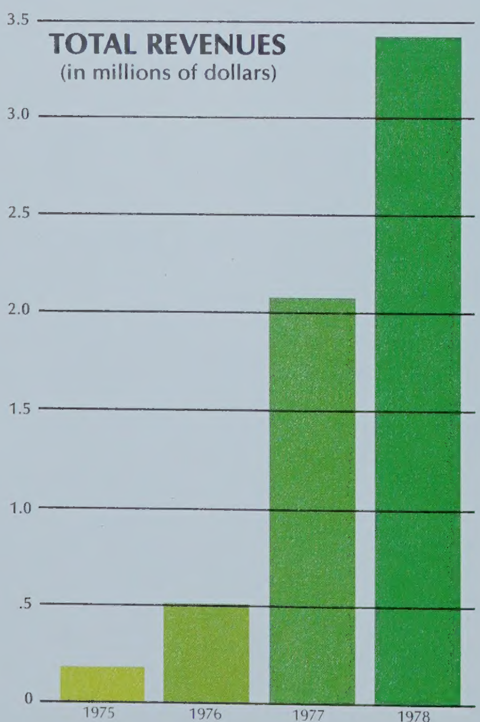
Financial	**1978**	**1977**
Revenue	**$ 3,428,017**	$ 2,083,285
Cash flow from operations	**$ 2,626,404**	$ 1,679,906
Cash flow per share	**$ .37**	$ .25
Net Earnings	**$ 1,533,155**	$ 995,389
Earnings per share	**$ .22**	$ .15
Total Assets	**$ 23,223,401**	$ 10,692,561
Shares Issued	**7,122,600**	6,835,200
Reserves		
Gas (Bcf)	**123.6**	95.9
Oil (Bbls.)	**1,500,000**	956,000
Production		
Gas (Bcf/year)	**2.06**	1.52
(MMcf/day)	**5.69**	4.18
Oil (Bbls/year)	**69,679**	40,420
(Bbls/day)	**191**	111
Drilling Activity		
Gas Completions	**40**	35
Oil Completions	**18**	9
Dry and Abandoned	**35**	10
Total Wells	**93**	54
Land		
(Gross Acres)		
Alberta	**243,094**	118,960
British Columbia	**133,893**	108,468
United States	**31,152**	155
Total Acreage	**408,139**	227,583

To The Shareholders

I am pleased to report that 1978 was another year of significant growth for Czar Resources Ltd. Substantial gains were recorded in gross revenue, cash flow and earnings due to a combination of increased production and higher prices for oil and gas.

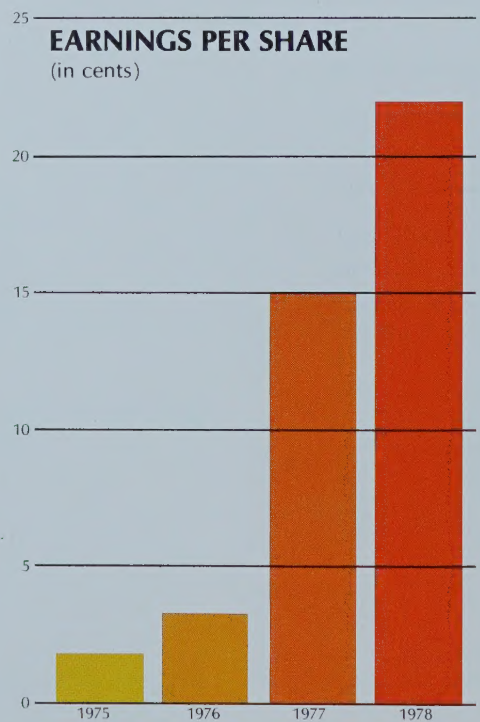
For the year ended October 31, 1978, gross revenue was $3,428,017, an increase of 64% over fiscal 1977's gross revenue, cash flow was $2,626,404 as compared to $1,679,906 in 1977 and earnings increased 47% from $.15 per share in 1977 to $.22 per share in 1978. During fiscal 1978, Czar Resources increased its line of bank credit to $7.2 million of which $5.6 million was drawn down and used primarily for the acquisition of oil and gas rights and installation of gathering systems and production facilities.

In an effort to give the Company a greater following in terms of shareholders, the Company applied for and was accepted for trading on The Toronto Stock Exchange. In addition, a resolution was passed at a special general meeting of the shareholders of Czar Resources Ltd. which resulted in the issuance of two additional shares of Company stock for each outstanding share.



During the year the Company entered into its sixth drilling program agreement with its West German fund raising partner, which raised approximately $10 million for investment by Czar Resources Ltd. in its exploration program. The Company also participated in two joint ventures with a Canadian fund raising company which raised $2.8 million in March, 1978 by way of a private placement and an additional $6.3 million in November of 1978 by way of a public prospectus. Eighty percent of the proceeds from the private placement and 100% of the proceeds from the public offering are to be invested by Czar in its drilling program.

In the November, 1978 Budget Speech, the Minister of Finance proposed that the tax incentives afforded to individuals investing in the oil and gas industry be extended to December 31, 1981. Canadians in general have taken advantage of the opportunity presented to them and have accepted the drilling fund concept as a method by which they can participate directly in the oil and gas industry and at the same time receive a significant tax deduction. The drilling fund concept has, in our opinion, served the purpose for which it was designed. It has encouraged Canadians to invest in the oil and gas industry thus giving the industry more Canadian content and has provided exploration companies with funds to continue the exploration for and development of new hydrocarbon reserves at a time when there is a shortage of petroleum substances. If the proposed extension is ratified, and we anticipate that it will be, the Company will have access to an additional long term source of financing for its exploration program which will complement the West German drilling funds and its increasing cash flow.



During 1978, the Company and its drilling fund partners invested approximately $25 million on exploration in Canada and an additional $2.7 million on exploration in the United States, participating in 93 wells of which 58 wells were cased as oil or gas wells. Czar Resources Ltd. operated eight drilling rigs on a full time basis in Canada during 1978 giving the Company and its investors excellent exposure to a large number of quality geological prospects. This exposure to, and participation in, a large number of geological prospects has enabled the Company to continue its rapid rate of growth and to continue the success which it has exhibited to date.

Operations in the United States continued at a steady pace with the Company's wholly owned subsidiary, Czar Resources, Inc. participating in 14 wells. Four of these wells have been cased and when placed on stream, the production revenue should cover the overhead of our Houston Office. In fiscal 1979, we anticipate participating in several development wells on prospects in which Czar Resources, Inc. has earned an interest as well as investing approximately $2.5 million on new geological prospects in the United States.

Marketing of natural gas appears to be the one most significant problem facing oil and gas producers in Canada, however, we are optimistic that a decision to export additional volumes of natural gas will be forthcoming early in 1979 and that markets will be available in approximately two years time. The Company is continuing to establish reserves of natural gas in Canada as well as devoting a portion of its efforts and funds to the development of its existing producing properties, both oil and gas, and to the generation of new geological prospects which we consider to be potentially oil bearing. During 1978, Czar Resources Ltd. was successful in entering into several agreements with other companies involving lands which are contracted for the sale of natural gas. In other cases, the Company drilled successful wells in pools which are currently being produced and, pursuant to the provisions of the Alberta Oil and Gas Conservation Act, we were allowed to obtain a portion of the contract and place our wells on stream. As such, we were able to increase our natural gas production during 1978 in spite of the lack of markets for natural gas. Operations in the United States should provide the Company with the diversification in markets which it requires to partially immunize itself against the current gas marketing problem in Canada.

The coming year promises to be one of further growth and diversification for Czar Resources Ltd. Expenditures on oil and gas exploration and development in Canada and the United States during 1979 should total approximately $20 million. The Company will continue to operate in areas with which it has become familiar and in which it has significant land holdings. Each year however, the Company has embarked on exploration programs in several new areas in Alberta and British Columbia thus expanding the Company's exploration effort. It is our opinion that significant reserves can be developed in these new areas by the time additional gas exports are realized. We also intend to dedicate time to the development of geological prospects in the Province of Saskatchewan as well as in the States of Montana, Wyoming, and North and South Dakota. It is our intention to raise a drilling fund in the United States to aid in financing our exploration program in that country and to act as operator for a new Canadian drilling fund which will be offered early in 1979. The Company also anticipates raising several million dollars through an equity placement in 1979 in order to increase its financial base and supports its continuing expansion.

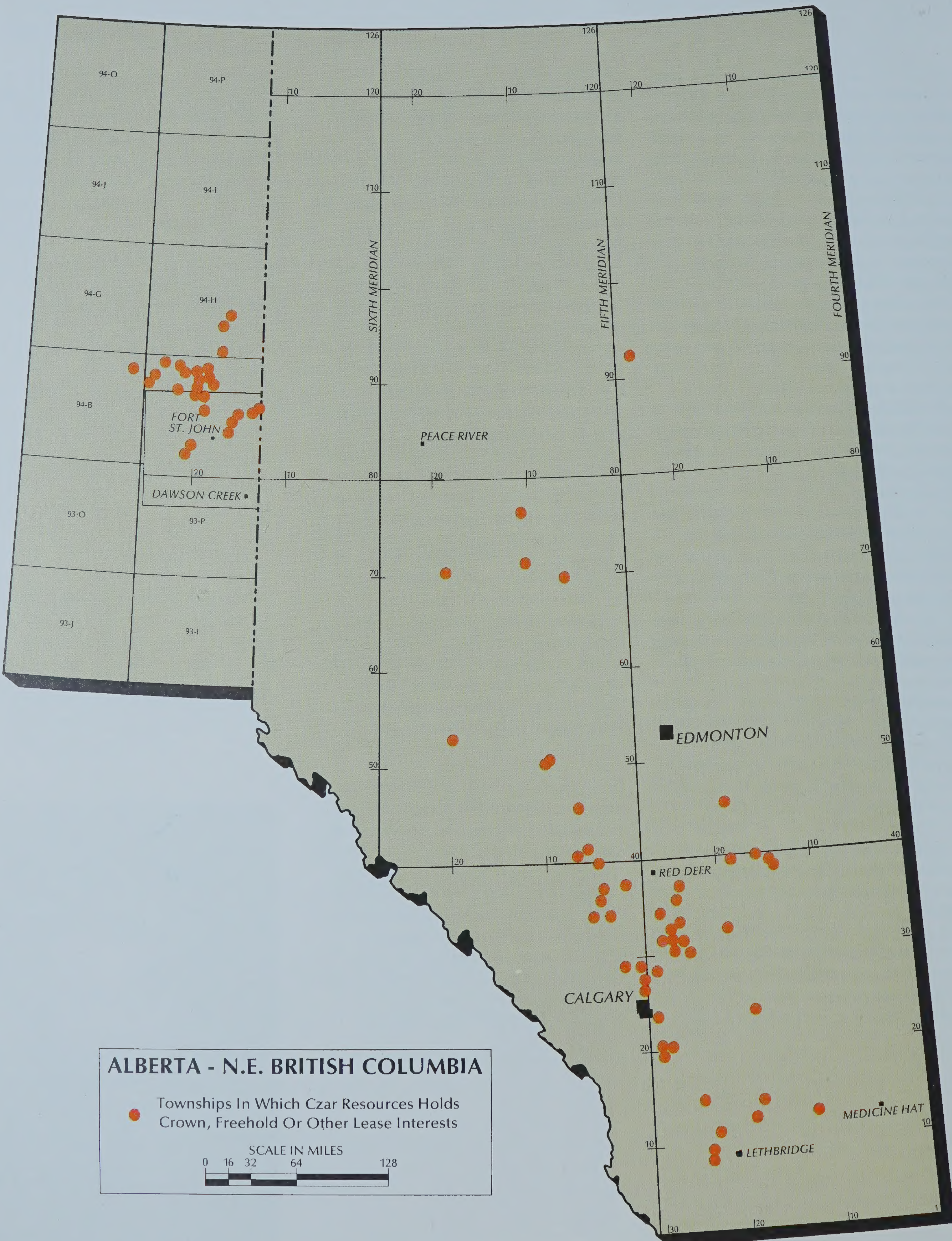
During 1978, Czar Resources Ltd. expanded its staff in order to conduct its increased exploration program in an orderly fashion. Leslie J. Broker, P. Kimberly Swyden and Linwood H. Gray joined Czar Resources, Inc. as Manager, Chief Landman and Geologist respectively. In Canada, Bonnie O. Rawlyck, Rod J. Blair, and Robert H. Johnston joined Czar Resources Ltd. as Controller, Production Superintendent and Area Geologist respectively. During 1978, W. Robert Venables supervised exploration activities in British Columbia and Graham B. Livesey coordinated the Company's exploration program in southern Alberta. Tony Convey, the Company's drilling superintendent, was responsible for coordination of the enlarged 1978 drilling program.

Although the staffs of the Company and its subsidiaries are relatively small in comparison to other companies with equivalent exploration budgets, they are experienced and proficient in their various functions and I wish to extend to the employees of Czar Resources Ltd. and Czar Resources, Inc. the thanks of the Board for their loyalty, diligence and dedication which has contributed so much to the performance of the Company.

On behalf of the Board,

R. W. Lamond,
President.

March, 1979.



ALBERTA - N.E. BRITISH COLUMBIA
Townships In Which Czar Resources Holds Crown, Freehold Or Other Lease Interests
SCALE IN MILES
0 16 32 64 128
SIXTH MERIDIAN
FIFTH MERIDIAN
FOURTH MERIDIAN
94-O
94-P
94-J
94-I
94-G
94-H
94-B
93-O
93-P
93-J
93-I
FORT ST. JOHN
DAWSON CREEK
PEACE RIVER
EDMONTON
RED DEER
CALGARY
MEDICINE HAT
LETHBRIDGE

Exploration — Canada

Czar Resources Ltd. continued its aggressive approach to exploration in Western Canada during 1978, drilling and participating in 79 wells of which 54 wells were cased as oil or gas wells for a success rate of 68 percent. It also continued with its philosophy of operating in areas where it has producing properties and where it has developed an expertise, as is evidenced by the fact that a large percentage of the wells drilled were located in the Fort St. John area of British Columbia and in Central Alberta, south of Edmonton. The Company embarked on an exploration program in areas new to it by participating in several shallow gas wells in Eastern Alberta and by participating in a deep well program in the area south of Calgary to the United States border. The results of these ventures, although not significant in terms of additional reserves to the Company, have been encouraging and Czar will continue to operate in these new areas.

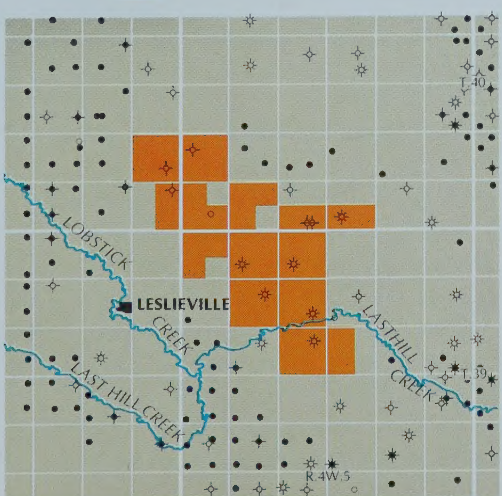
Alberta

Medicine River

The Company drilled three successful wells in the Medicine River area during fiscal 1978 extending the limits of a Glauconite gas pool discovered by Czar in 1977. Five successful wells have now been drilled in the Medicine River pool, each with an average net pay of 13 feet.

MEDICINE RIVER

Gas Well · Oil and Gas Well · Dry Hole · Location · Oil Well · CZAR PROSPECT ACREAGE



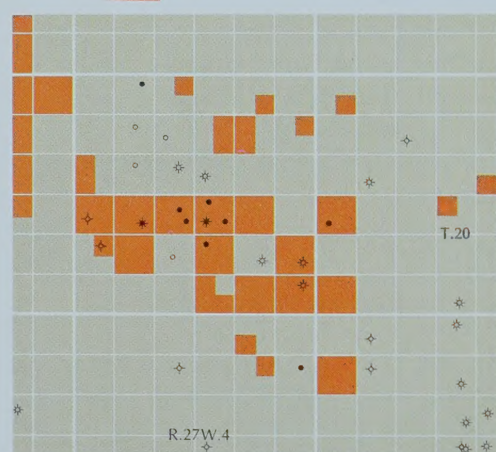
All of the wells are capable of producing from 3 MMcf to 7 MMcf of gas per day, with a condensate content of 85 barrels per million cubic feet of gas. Recoverable reserves for the pool are estimated to be in excess of 100 Bcf of sales gas and 4 million barrels of condensate. A gas purchase contract has been signed for the Medicine River reserves, but it will be approximately two years before any gas will be sold from the pool because of the uncertainties associated with gas marketing. In the interim, Czar is reviewing the feasibility of instituting a re-cycling project in the area whereby the gas is produced, the condensate is removed and the gas is re-injected into the reservoir. Although the operation is expensive, gross production from the pool could exceed 1,300 barrels of condensate and LPG liquids per day. At least one development well will be drilled in the Medicine River area during 1979, and a comprehensive study of the re-cycling operation will be completed. Czar and its West German drilling fund partner have working interests ranging from 21.875% to 87.50% in approximately 7,200 gross acres in the Medicine River area.

Gladys/Blackie

Drilling operations continued in the Gladys/Blackie area where the Company participated in seven successful wells during 1978. One of the wells drilled was completed as a gas well, and the remaining six wells were completed as either Basal Quartz oil wells or Mississippian oil wells bringing the total number of oil wells drilled by the Company in the Gladys/Blackie area to eight. Two of the wells drilled this year also encountered gas in commercial quantities in the deeper Crossfield zone, however, the wells have been temporarily plugged back to the shallower oil producing horizons because of the current lack of markets for natural gas. The Basal Quartz wells, Sabine et al Blackie 11-10-20-27-W4M and Sabine et al Blackie 8-15-20-27-W4M have net pay thicknesses of approximately 18 feet and 105 feet respectively. Net pay thicknesses in the Mississippian wells range from a low of 8 feet in the Sabine et al Blackie 7-17-20-27-W4M well to a high of 125 feet in the Sabine et al Blackie 14-15-20-27-W4M well. Initial oil reserves in place in the Basal Quartz and Mississipian reservoirs are calculated to be 71,928,000 barrels with initial recoverable oil reserves estimated to be 17,982,000 barrels. Several of the Mississippian wells drilled in the Blackie pool are capable of producing in excess of 100 barrels of oil per day on sustained production, however, due to the provincial allowable determination, the wells are each producing only 30 barrels per day. Application has been made by the operator to the Energy Resources Conservation Board for a pool allowable which, if granted, would allow production in the Gladys/Blackie area to increase from 180 to 300 barrels of oil per day. Czar and its West German drilling fund partners have interests varying from 12.50% to 25.00% in the wells and in 9,920 gross acres in the area. Several development wells will be drilled in the Gladys/Blackie area during 1979 in order to further delineate the limits of the pool.

GLADYS/BLACKIE

Gas Well · Oil and Gas Well · Dry Hole · Location · Oil Well · CZAR PROSPECT ACREAGE

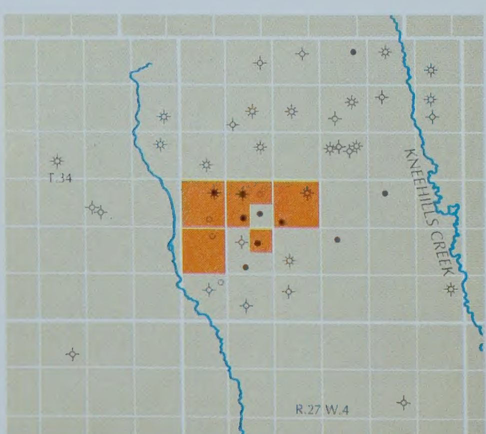


Davey Lake

The Company drilled two wells in the Davey Lake Field during 1978 in an effort to increase oil production from this Mississippian pool. The wells, Czar et al Davey 10-18-34-27W4M and Czar et al Davey 11-17-34-27-W4M both encountered gas in the Belly River formation and oil in the Pekisko formation. The Davey 10-18 well penetrated 23 feet of net pay in the Belly River formation and recovered 330 feet of oil from a test over 31 feet of net pay in the Pekisko. The well has been completed as a Pekisko oil well and is producing approximately 40 barrels of oil per day. The Davey 11-17 well tested 100 Mcf of gas per day from 21 feet of net pay in the Belly River formation and recovered oil on a test of 31 feet of net pay in the Pekisko formation. The well has been completed as a Pekisko oil well and is producing at its daily allowable of 40 barrels. Czar Resources Ltd. has working interests in four producing Pekisko oil wells in the Davey Lake area and will drill additional development wells during 1979. A unitization scheme for the Belly River formation in the Davey Lake area is being reviewed and if it comes to fruition, Czar would receive additional revenue from the sale of not only the Belly River gas, but also gas being produced in association with the Pekisko oil. The Company and its fund partners have working interests varying from 36.785% to 80.00% in the wells and 2,560 gross acres in the Davey Lake area.

DAVEY LAKE

Gas Well — Oil and Gas Well
Dry Hole — CZAR PROSPECT ACREAGE
Oil Well

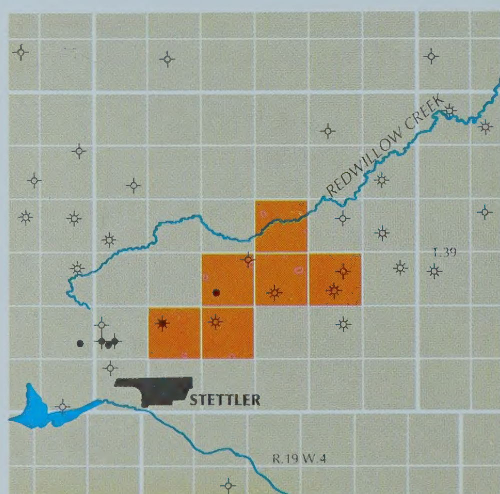


Leahurst

At Leahurst, Czar Resources Ltd. drilled a dual zone Basal Quartz and Viking oil well. A test of the Viking formation recovered 853 feet of oil from 4 feet of net pay and a test of the Basal Quartz formation recovered 120 feet of oil and 350 feet of drilling fluid from 31 feet of net pay. The well has been completed in the Basal Quartz formation and is producing 35 barrels of oil per day. Reserves for the Basal Quartz formation are estimated to be 119,000 barrels of oil per quarter section. The Company has three shut-in Lower Cretaceous gas wells in this area in addition to two producing Lower Cretaceous oil wells. Czar and its fund partners have working interests varying from 50% to 100% in the wells and 3,840 gross acres.

LEAHURST

Gas Well — Oil and Gas Well
Dry Hole — CZAR PROSPECT ACREAGE
Oil Well

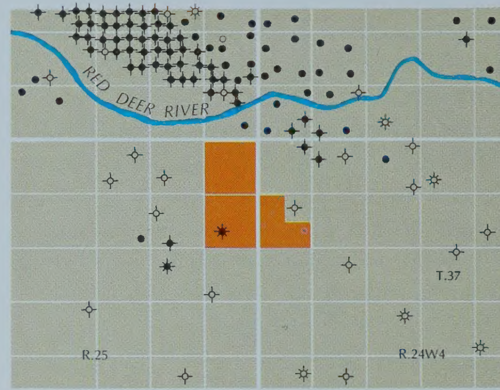


Joffre

Czar et al Joffre 6-25-37-25-W4M was completed as a Nisku oil well and is currently producing approximately 50 barrels of oil per day. The well, which is capable of producing 150 barrels of oil per day, also encountered oil and natural gas in two zones of Lower Cretaceous Age. The Company is attempting to acquire additional lands in this area and will drill a follow-up well during 1979. Czar and its fund partners have interests varying from 50% to 100% in 1,760 gross acres in the Joffre area.

JOFFRE

Gas Well — Oil and Gas Well
Dry Hole — CZAR PROSPECT ACREAGE
Oil Well



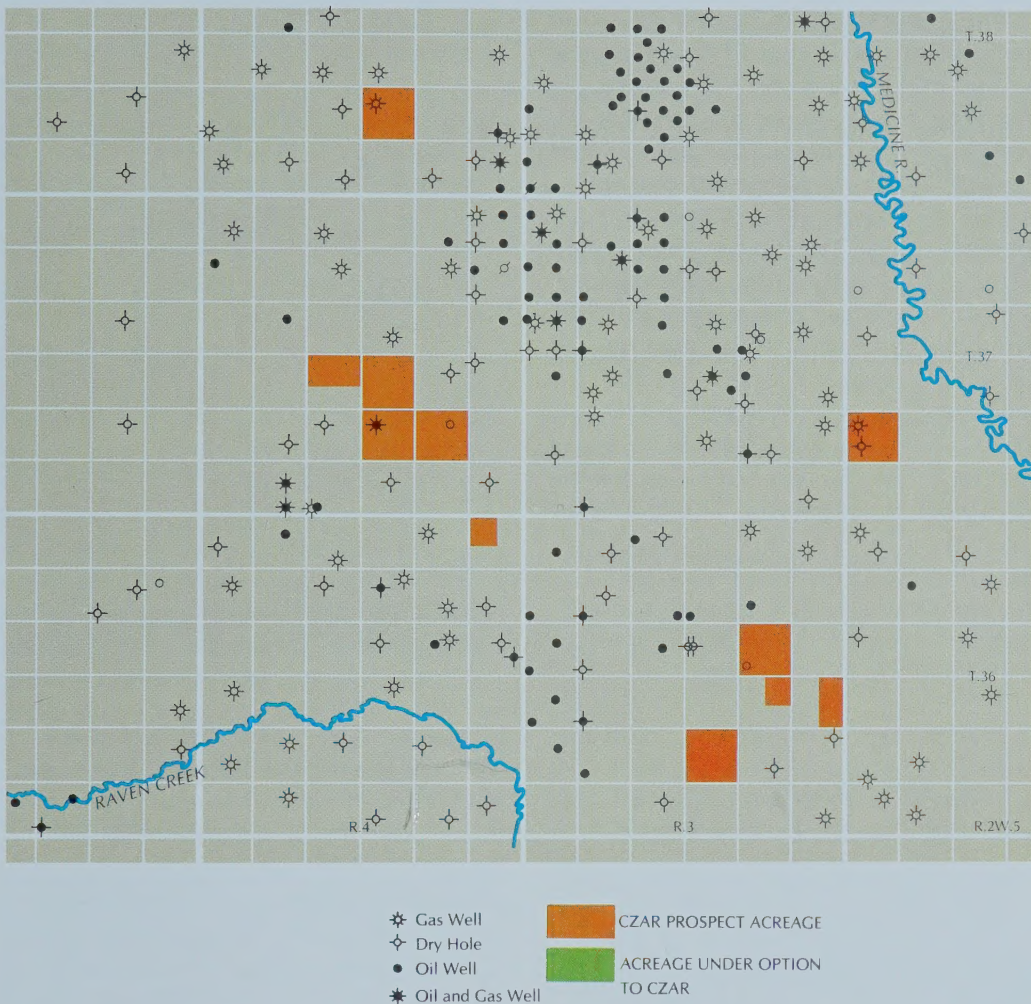
Sylvan Lake

Czar Resources Ltd. participated in two wells in this area during the year, the Czar et al SyLake 11-10-38-4-W5M well, which drill stem tested 1.42 MMcf of gas per day from the Basal Quartz zone and the Czar GAO SyLake 11-10-37-4-W5M well which has been completed as a Basal Quartz oil well. The Sylvan Lake area of Alberta is an extremely prolific hydrocarbon bearing region in which the Company will operate aggressively. At the time this report was written, Czar Resources Ltd. was participating in the drilling of two additional wells at Sylvan Lake.

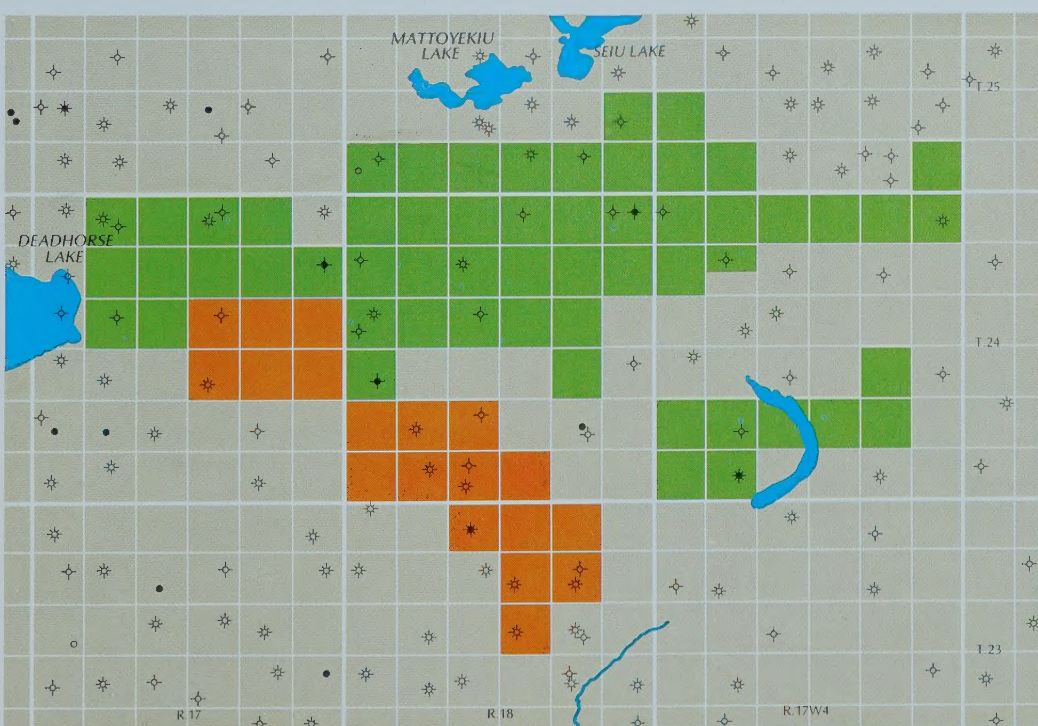
Hussar

A development well was drilled on Company acreage near Hussar bringing to a total of six the number of wells producing through a recently completed gas plant in this area. Production averaged 6 MMcf of gas per day during 1978. The Company and its fund partners have an interest varying from 25% to 50% in the producing wells. During 1978 Czar entered into an agreement which provides for the drilling of a minimum of eight wells on contracted lands located adjacent to the Company's current land holdings. By so doing, Czar will earn an interest in 20,480 gross acres. The Company, at its option, may drill up to 6 more wells and earn an interest in an additional 15,360 gross acres of land which are also subject to a gas sales contract.

SYLVAN LAKE



HUSSAR



Other Areas

During 1978 two Basal Quartz wells were drilled in the Irricana area, where the Company has significant land holdings. Production from the wells will be monitored prior to undertaking any additional drilling operations. At Pearce, in Southern Alberta, the Company drilled a Mississippian oil well and a Devonian oil well. Both of these wells are being production tested and additional drilling is being contemplated. The Company drilled successful gas wells at Bashaw, Antelope, Alderflats and Faust, where follow-up drilling will be conducted during 1979. At Parkland, in Southern Alberta, the Company participated in a Mississippian gas well and elected to exercise an option to drill an additional well in the area early in 1979. The Company views the region south of Calgary to the United States border as one of high hydrocarbon potential. This potential for discovery and development of hydrocarbons along with the fact that lands are relatively inexpensive and operations can be conducted year round contributes to making this an attractive area and one in which the Company intends to conduct extensive exploratory operations during 1979.

British Columbia

Boudreau

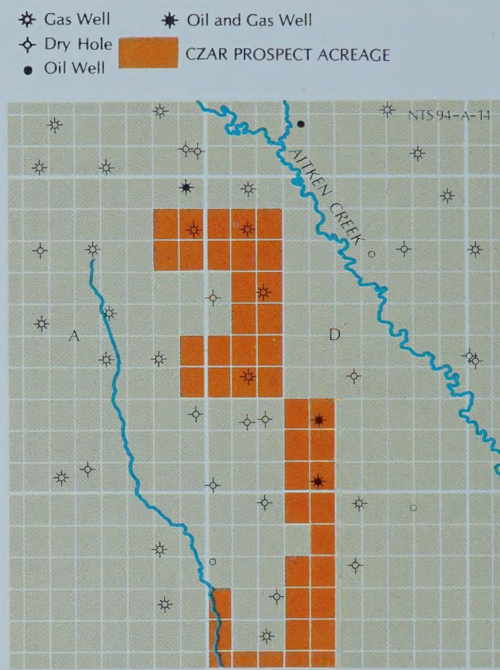
During 1978, Czar Resources Ltd. drilled five wells in the Boudreau area completing four of the wells as Triassic gas wells. A sixth well is currently being drilled and it is anticipated that at least two more delineation wells will be drilled by the Company during 1979. At this time it appears that the Company and its partners have discovered a second significant hydrocarbon reserve six miles north of the Monias Field. The geological structures at Boudreau and Monias appear to be of similar magnitudes but detailed information on the wells drilled to date is being held tight for competitive reasons. The Company and its fund partners have interests varying from 20% to 58% in the wells and 13,512 gross acres in the Boudreau area.

Fireweed

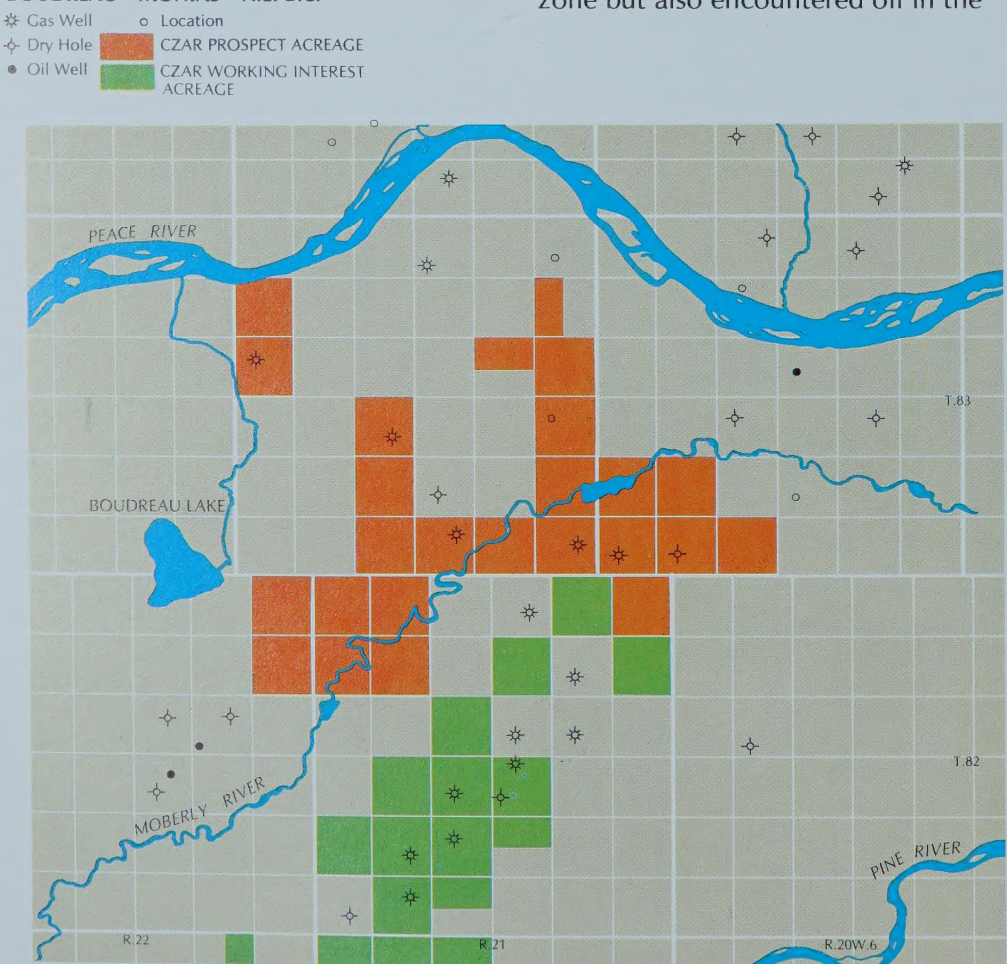
The Company has two wells on stream at Fireweed and during 1978 participated in four additional wells in the area. The Czar et al Fireweed b-68-D/94-A-14 well in which Czar and its fund partners have a 70% working interest, encountered natural gas in the Bluesky and Dunlevy zones. The Bluesky zone, which has 11 feet of net pay, tested 2 MMcf of gas per day and the Dunlevy zone tested 4.5 MMcf of gas per day from 76 feet of net pay. A second well, the Czar et al Fireweed d-39-D/94-A-14 well, was completed in 70 feet of net pay in the Dunlevy zone after testing 2.1 MMcf of gas per day. This well is located on lands subject to an existing gas contract and will be placed on stream early in 1979. Czar and its fund partners have a 37.5% working interest in the well.

The two remaining wells, located at b-26-D/94-A-14 and b-6-D/94-A-14 encountered natural gas in the Dunlevy zone but also encountered oil in the Doig zone. The b-26-D well tested 6.4 MMcf of gas per day from 109 feet of net pay in the Dunlevy zone and had an initial flow rate of approximately 440 barrels of oil per day from 51 feet of net pay in the Doig zone. The b-6-D well in which Czar and its fund partners have a 12.5% working interest, encountered 35 feet of net pay in the Dunlevy zone and tested gas at a rate of 2 MMcf per day from that zone. The well had 19 feet of net pay in the Doig zone which had an initial flow of approximately 240 bbls of oil per day. Czar and its fund partners have a 50% working interest until payout in the b-26-D well whereupon the interest is reduced to 30%. Production facilities have been installed at the well locations and allowables have been requested for oil production from the Doig zone. The wells will be production tested for an extended period of time in order to ascertain the limits of the Doig reservoir prior to conducting additional drilling in the area.

FIREWEED—N.E. B.C.



BOUDREAU—MONIAS—N.E. B.C.

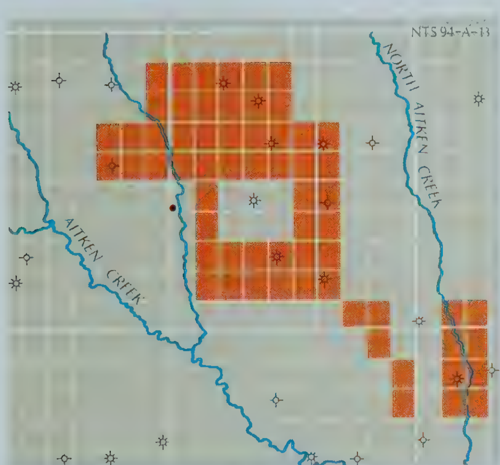


Birch

In the 1977 Annual Report, it was stated that the Company had drilled three successful gas wells on its Birch acreage. Two additional wells have been drilled, Czar et al Birch b-26-I/94-A-13 and the Czar et al Birch b-88-I/94-A-13, both of which have been completed as gas wells. The b-26-I well flowed 2.4 MMcf of gas per day on completion from the Baldonnel Formation and the b-88-I well flowed 7.5 MMcf of gas per day from the same zone in the Baldonnel. Additional lands have been acquired in the area and two wells will be drilled by the Company on its Birch acreage during the summer of 1979. Production from this field should total approximately 7.5 MMcf of gas per day during the winter months. Czar and its fund partners have an 85% working interest in six wells and 4,879 gross acres plus a 42.50% working interest in an additional 2,400 gross acres.

BIRCH—N.E. B.C.

Gas Well · Oil Well · Dry Hole · CZAR PROSPECT ACREAGE

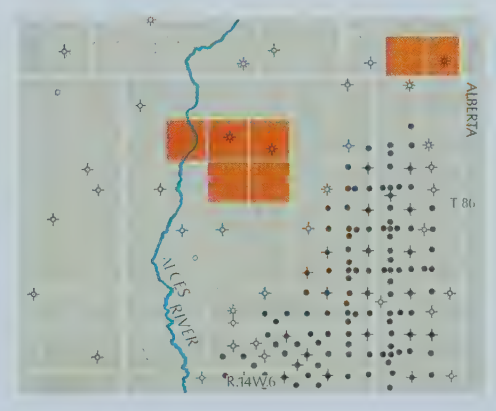


Oval

During 1978, the Company drilled two successful wells at Oval near the Alberta-British Columbia border. Czar et al Oval 10-28-86-14 W6M encountered 20 feet of net pay in the Halfway sand and has been completed as a gas well with an AOF of 5.4 MMcf of gas per day. Czar et al Oval 7-27-86-14 W6M, a step-out to the Oval 10-28 well, failed to find the Halfway productive, but did discover gas in the Bluesky Formation which on completion flowed 800 Mcf per day. This area is being evaluated for possible further drilling.

OVAL—N.E. B.C.

Gas Well · Location · Dry Hole · CZAR PROSPECT ACREAGE · Oil Well



Aspen

At Aspen, Czar has drilled three wells, two of which have been completed as Triassic gas wells. On completion, the Czar et al Aspen, d-17-J/94-A-13 well flowed 2.8 MMcf of gas from the Coplin dolomite zone. Czar et al Aspen c-40-J/94-A-13 encountered gas in both the Coplin and Baldonnel dolomites with 5 feet and 52 feet of net pay respectively. The Czar et al Aitken a-49-J/94-A-13 well, re-entered by Czar in 1977, also has 5 feet of net pay in the Coplin and 50 feet of net pay in the Baldonnel and is awaiting completion as a dual zone gas well. Czar and its fund partners have interests varying from 50% to 100% in the wells and in 9,767 gross acres in the area.

Other Areas

Successful wells were drilled at Weasel, Cache, Goldenrod and Montney during 1978. The Company re-entered Weasel d-95-B/94-H-2 and completed the well in the Halfway Formation with an AOF of 1.4 MMcf of gas per day. A successful step-out well, in the Cache field, Wainoco et al Cache b-48-L/94-A-11 has been cased as a dual zone Coplin and Halfway gas well. The Coplin zone has not yet been completed, however, the Halfway Formation flowed gas at a rate of 5.5 MMcf per day on completion. At Goldenrod, the Company drilled two successful Triassic gas wells and is currently evaluating them. In the Montney area, Czar drilled a Charlie Lake oil well which is producing at a rate of 50 BOPD. A one and one half mile step-out to the well failed to find the same zone and was abandoned. The Czar et al Squirrel 7-26-87-19 W6M well will be produced for an extended period of time to ascertain the reservoir limits prior to the Company conducting additional drilling operations.

Exploration — United States

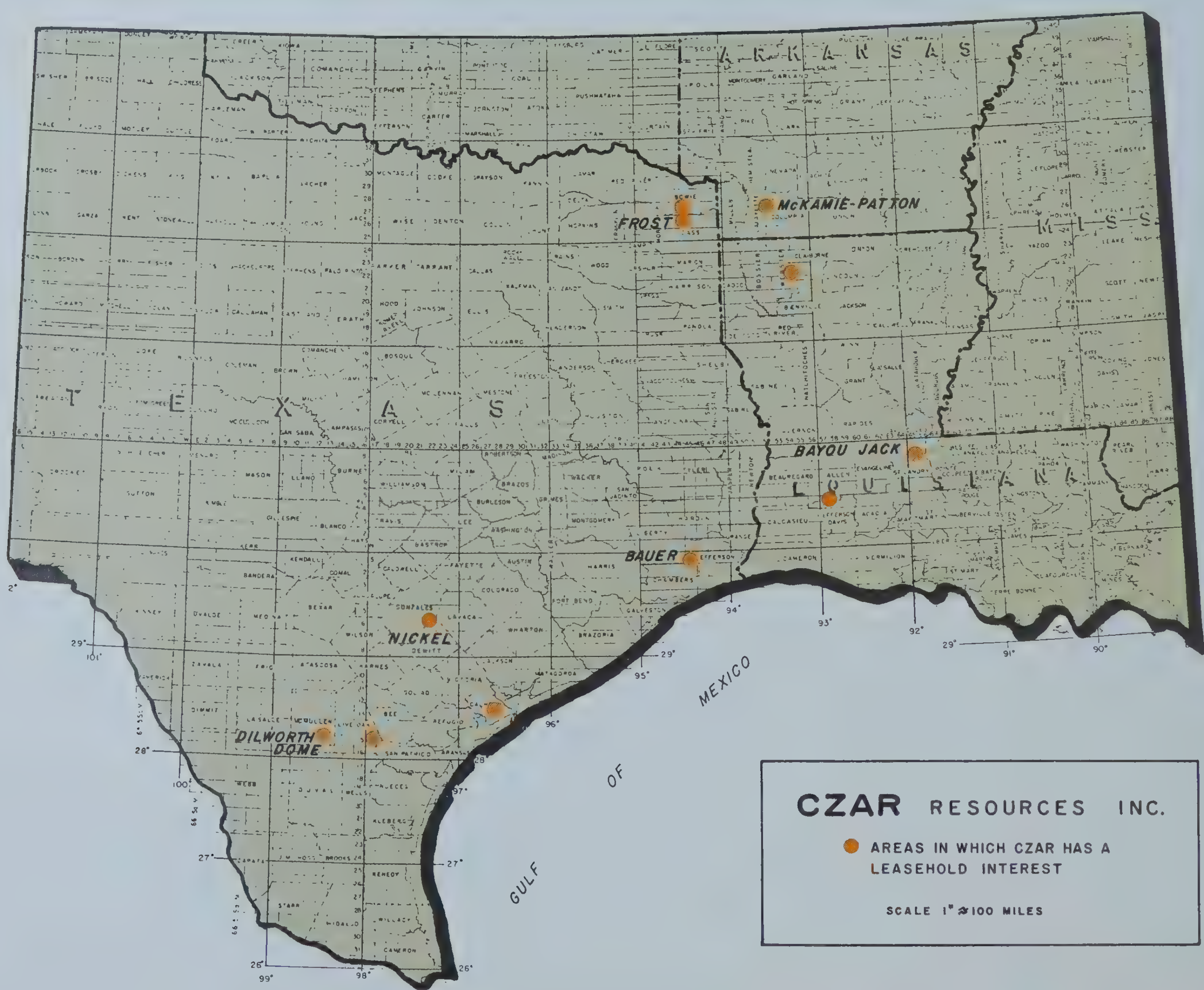
During 1978, the Company through its wholly-owned U.S. subsidiary, Czar Resources, Inc., participated in 14 wells of which 4 were cased and are either waiting on completion or have been completed. The Company has attempted to restrict its activity in the United States to prospects located onshore in the States of Texas and Louisiana, however, it has also participated in an exploration program in Arkansas and is reviewing prospects in Montana and Wyoming. Approximately $2.7 million was expended on exploration in the United States during 1978 and it is anticipated that a similar amount of money will be invested on exploration in the United States during 1979. Czar Resources, Inc. has generated and acquired an inventory of prospects in Texas, Louisiana and Montana which will be drilled in 1979. In addition, the subsidiary has developed and will continue to develop higher risk—higher reserve prospects which will be farmed out to other operators thereby reducing the Company's cost while maintaining exposure to those prospects with high reserve potential.

Frost Field

Czar Resources, Inc. participated in a Smackover prospect in Cass County, Texas. The well, which encountered 18 feet of oil pay in the Smackover, is estimated to have reserves of approximately 526,000 barrels for the 80-acre spacing unit. The well is currently suspended because of access problems, however, it will be completed early in 1979. Czar Resources, Inc. and its fund partners have a 25% working interest in the well and 640 gross acres on the prospect. An offset to the well is scheduled for the second quarter of 1979.

Nickel

In Gonzales County, Texas, Czar Resources, Inc. has assembled 12,000 gross acres along the prolific Austin Chalk oil trend. Early in 1979 wells will be drilled on each end of a 9,000-acre block in which Czar has a 50% working interest, thereby providing an evaluation for the acreage block. One of the wells will be drilled free of cost to Czar with Czar retaining a 25% interest in the second well.



Dilworth Dome

The Company and its West German drilling fund partners participated in a 10,700 foot Edwards test on the flank of a salt dome in McMullen County, Texas. The well, Petrus Operating #1 Martin, encountered 526 feet of net pay in the Edwards and on perforation flowed gas at a rate of 1.5 MMcf per day. A gas contract has been signed with a major gas purchasing company which provides for deliverability of up to 9 MMcf of gas per day at an initial contract price of $1.97 per Mcf. The well, because of its high hydrogen sulphide content, will be fractured and completed into a pipeline which is being constructed to the wellhead by the gas purchaser. Reserves for the well and the 40 acre spacing unit are estimated at 32 Bcf of gas. Czar and its drilling fund partners have a 6.25% working interest in the well and 1,600 acres on the prospect. Additional wells will be drilled early in 1979.

Bauer Ranch

The Sklar Phillips #1 Lohman, drilled in Jefferson County, Texas, encountered 27 feet of pay in the Nodosaria Sand and is currently on production at a rate of 2 MMcf of gas and 40 barrels of condensate per day. A half mile step-out to the producing well was drilled but the sand was found to be structurally low and the well was abandoned. A third location has been selected and the geology is being reviewed at this time to determine if the well will be drilled by Czar or farmed out to a third party. Czar and its West German fund partners have an 18.75% working interest in the well and 1,000 gross acres on the prospect.

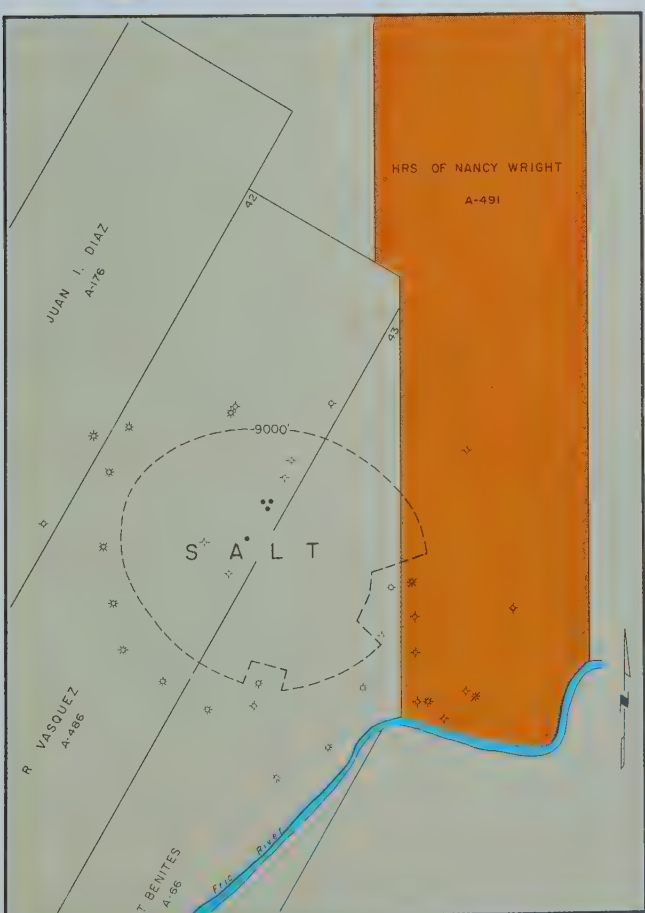
Other Areas

The Company participated in an oil prospect in Lafayette County, Arkansas. Two Cotton Valley wells have been drilled as well as one deeper Smackover test. The Smackover well has been abandoned and the Cotton Valley wells are waiting on completion. Additional drilling may be conducted in this area pending results of the completion attempts.

Czar has established an acreage position near the Bayou Jack Field on the deep Tuscaloosa trend in South Louisiana. Successful wells in the Bayou Jack Field average initial production of 10 MMcf of gas per day. Because of the high cost of drilling in this area, the 580 gross acres acquired will be farmed out to a third party.

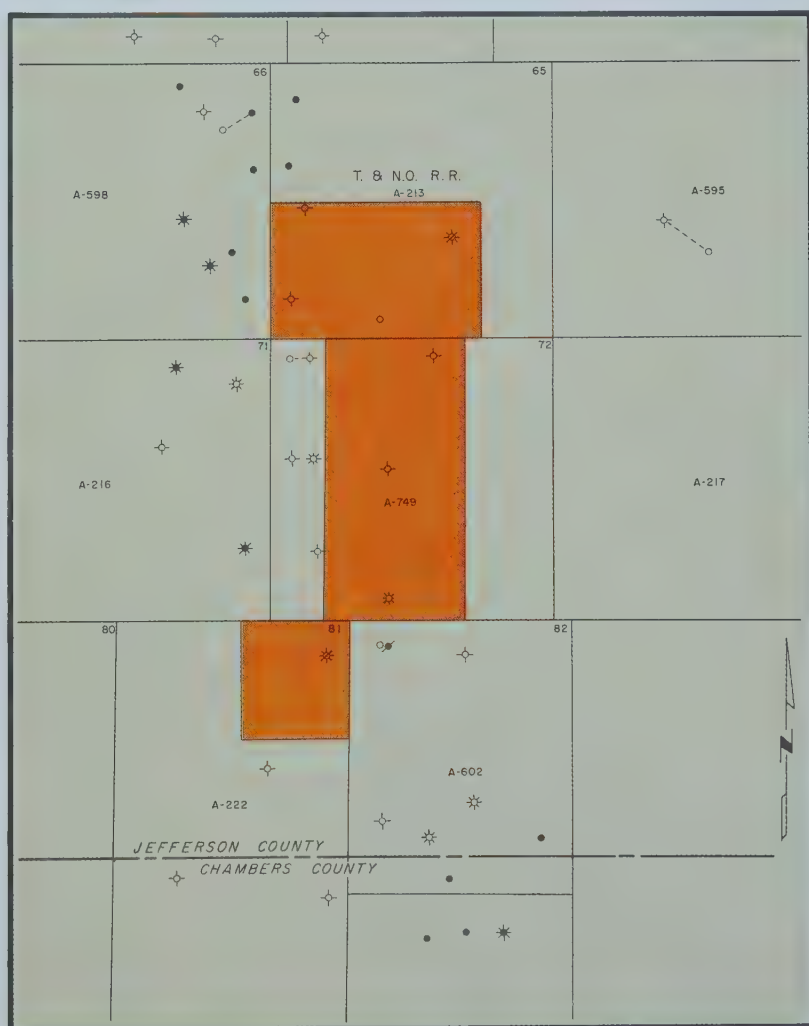
DILWORTH FIELD — McMULLEN COUNTY, TEXAS

Gas Well · Oil and Gas Well · Dry Hole · Location · Oil Well · CZAR PROSPECT ACREAGE



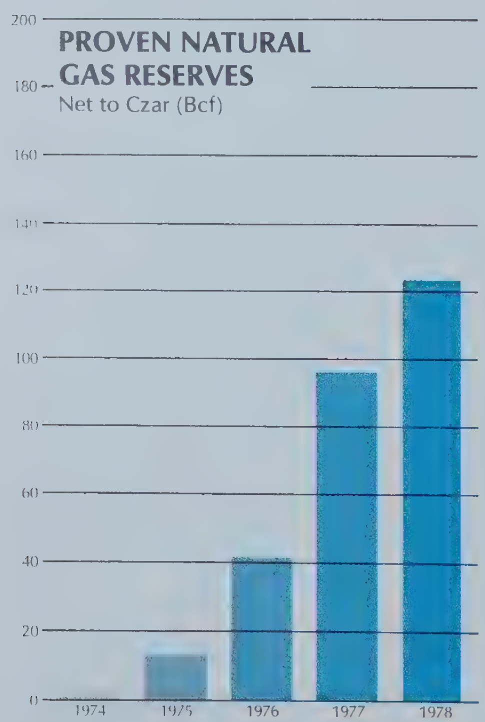
SOUTH BAUER RANCH — JEFFERSON COUNTY, TEXAS

Gas Well · Oil and Gas Well · Dry Hole · Location · Oil Well · CZAR PROSPECT ACREAGE



Reserves

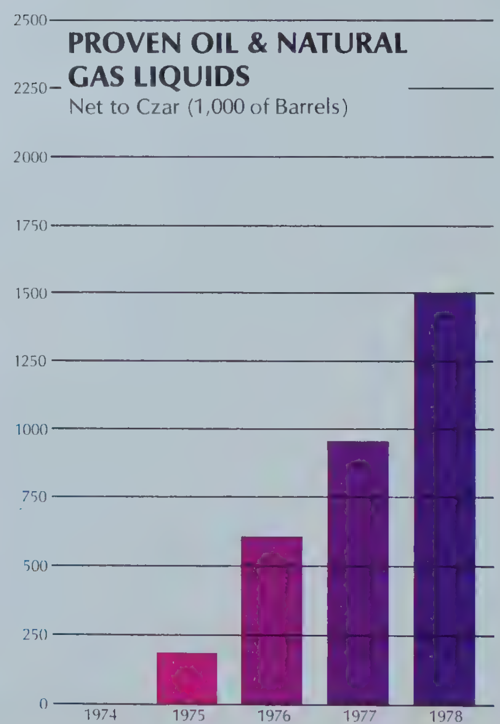
The Company estimates that proven reserves at the October 31, 1978 fiscal year end were 123.6 Bcf of gas and 1.5 million barrels of oil and natural gas liquids, which represents an increase of 29% and 57% respectively over the 1977 reserve figures. Subsequent to the October 31, 1978 fiscal year end, an evaluation of the Company's reserves of oil and gas was conducted by an independent engineering consulting firm which assigned net proven and probable reserves of 148 Bcf of gas and 1.59 million barrels of oil and natural gas liquids to the Company's lands. In general exploration and producing companies state their oil and gas reserves in gross figures. It is of significance to note that the reserves of the Company are shown as net reserves, in other words, after deduction of Crown and freehold royalties.



Production

Net production to the Company for fiscal 1978 was 2.06 Bcf of gas and 69,679 barrels of oil compared with 1.52 Bcf of gas and 40,420 barrels of oil in fiscal 1977. Wells were placed on stream at Hussar, Retlaw, Lanaway, and Gladys/Blackie in Alberta and at Monias, Dahl, Birch and Flatrock in British Columbia with the production revenue from these properties contributing substantially to the Company's cash flow. The Company currently operates eighteen producing properties involving 48 wells in Alberta and British Columbia.

A gas plant was constructed at the Twining Battery facility to process natural gas being produced in association with the Company's oil production. The construction of the gas plant has resulted in additional production of approximately 680 Mcf of gas per day. At Hussar, in Southeastern Alberta, a gas plant was constructed and is currently processing gas from 6 wells in the area. Production at the plant is approximately 6 MMcf of gas per day. The Company operates the gas plant and has a 53% working interest in it and associated facilities. Single wells were placed on stream at Sylvan Lake and Retlaw with production to the Company and its partners averaging 1.2 MMcf of gas per day from the Sylvan Lake well and 1.5 MMcf of gas per day from the Retlaw well. The Company participated as to 25% in the construction of a battery facility in the Gladys/Blackie area to process oil being produced from several Mississippian and Basal Quartz wells.



In British Columbia, the Company, as operator of the Monias Field, constructed a 22 mile pipeline from the Taylor Gas Plant near Fort St. John to the Monias Field, allowing the Company to place on stream natural gas reserves discovered in 1977. Gross production from the Monias Field which has reserves in excess of 250 billion cubic feet of gas is averaging 28 MMcf of gas per day. The pipeline was sold late in 1978 to Westcoast Transmission Company Ltd.

Three wells were placed on stream at Birch in British Columbia and are currently producing 2 MMcf of gas per day. Production from the wells declined from approximately 4 MMcf of gas per day to the current rate as a result of an increase in the line pressure of the transmission company's main pipeline. Two additional wells have been drilled and a previously abandoned well has been re-entered successfully. The Company anticipates having two of these wells on stream early in 1979 bringing total production from the area to 7.5 MMcf of gas per day.

Three wells in which the Company has a 13.33% working interest were placed on stream in the Nettles-Dahl area and are currently producing approximately 400 Mcf of gas per day net to the Company.

Negotiations are underway with the gas purchaser in British Columbia to contract additional gas for delivery in the fall of 1979. Contracts have also been requested for certain properties in Alberta, although the Company does not anticipate having these properties on stream until 1981.

Financial

Notwithstanding that three of the Company's major producing properties were shut-in during the summer months, Czar continued to exhibit steady growth in terms of revenue and earnings per share. Net earnings for 1978 increased 54% to $1,533,155 or 22¢ per share, compared with 15¢ per share in 1977, after adjustment for a three for one stock split. Revenue increased 64% to $3,428,017, of which approximately 70% was derived from production revenue

Capital expenditures amounted to $5.5 million, which were financed in part by a bank production loan of $1.4 million and an increase in the authorized operating loan from $2.5 million to $7.2 million. A major pipeline project in the Monias area in British Columbia was completed by the company during the year and sold to Westcoast Transmission Co. Ltd. subsequent to the year end, allowing the Company to recover its costs and overhead.

Czar increased its use of Canadian drilling funds by completing a second joint venture agreement with a Canadian company which contributed $2.24 million to Czar's 1978 exploration program. A third joint venture agreement was entered into in July, 1978 which provides for the expenditure of $6.3 million in Czar's exploration program during the latter part of 1978 and early 1979.

In May, 1978, the Company was listed for trading on The Toronto Stock Exchange and in September 1978 the Company split its stock on a three for one basis to provide a wider distribution and following of the Company's shares.

At present, an equity placement of the Company stock is under consideration by a major brokerage house. Although the specific terms of the placement have not been determined the management of the Company feels that the placement is necessary to provide Czar with the funds which it requires to continue its rapid rate of growth and to provide it with a stable financial base.

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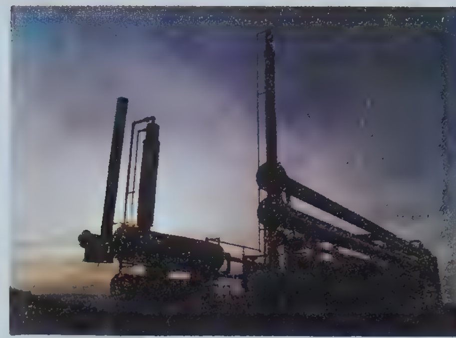

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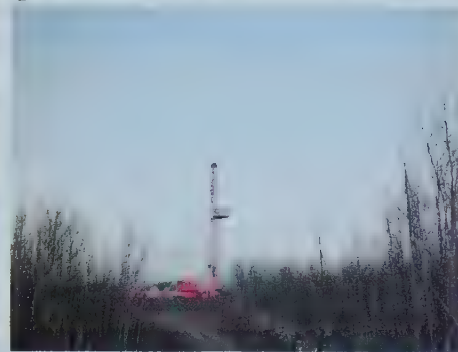

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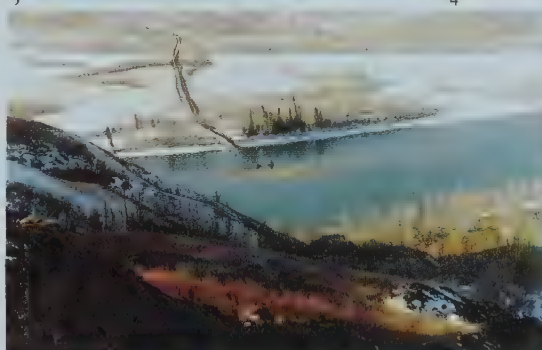

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1. *Right-of-Way—Monias Pipeline.*
2. *Gas Processing Plant—Hussar.*
3. *Drilling Rig—Northeastern B.C.*
4. *Rail Cars of Pipe—Monias Pipeline*
5. *Monias Pipeline—South Bank*
6. *Drilling Rig—Central Alberta.*
7. *Peace River Crossing—Monias Pipeline.*

CONSOLIDATED BALANCE SHEET

AS AT OCTOBER 31, 1978

ASSETS

	1978	1977
CURRENT ASSETS		
Accounts receivable—trade	**$ 3,886,025**	$ 1,137,570
—drilling partnerships (note 2)	**7,504,070**	3,762,408
Inventory of supplies, at lower of cost and net realizable value	**940,498**	60,868
	12,330,593	4,960,846
FIXED ASSETS (note 2)		
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	**11,368,530**	5,916,692
Accumulated depletion and depreciation	**475,722**	184,977
	10,892,808	5,731,715
	$23,223,401	$10,692,561

Approved by the Board:

Director

Director

LIABILITIES

	1978	1977
CURRENT LIABILITIES		
Bank indebtedness (note 3)	**$ 3,748,606**	$ 1,288,024
Accounts payable and accrued liabilities	**10,354,836**	4,147,444
Drilling advances	**314,060**	1,429,451
Current portion of long-term debt (note 4)	**500,000**	—
Income taxes payable	**104,563**	—
	15,022,065	6,864,919
LONG-TERM DEBT (note 4)	**1,375,000**	—
DEFERRED INCOME TAXES (note 1)	**1,434,599**	639,541

SHAREHOLDERS' EQUITY

CAPITAL STOCK (note 5)		
Authorized		
10,000,000 (1977—5,000,000) common shares without nominal or par value		
Issued		
7,122,600 (1977—2,278,400) common shares	**2,651,356**	1,980,875
RETAINED EARNINGS	**2,740,381**	1,207,226
	5,391,737	3,188,101
	$23,223,401	$10,692,561

CONSOLIDATED STATEMENT OF EARNINGS

YEAR ENDED OCTOBER 31, 1978

	1978	1977
REVENUE		
Production	**$1,658,230**	$1,054,267
Principal and interest from property dispositions (note 2)	**740,071**	413,487
Management fees (note 2)	**1,002,790**	605,018
Other	**26,926**	10,513
	3,428,017	2,083,285
EXPENSES		
Production	**131,446**	113,675
General and administrative	**282,838**	278,161
Depletion and depreciation	**296,602**	160,397
Other interest	**225,733**	11,543
Interest on long-term debt	**58,622**	—
	995,241	563,776
Earnings before income taxes	**2,432,776**	1,519,509
INCOME TAXES		
Current	**104,563**	—
Deferred	**795,058**	524,120
	899,621	524,120
NET EARNINGS	**$1,533,155**	$ 995,389
EARNINGS PER SHARE (note 6)	**$ .22**	$ .15

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED OCTOBER 31, 1978

	1978	1977
RETAINED EARNINGS AT BEGINNING OF YEAR	**$1,207,226**	$ 211,837
Net earnings	**1,533,155**	995,389
RETAINED EARNINGS AT END OF YEAR	**$2,740,381**	$1,207,226

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED OCTOBER 31, 1978

	1978	1977
WORKING CAPITAL DERIVED FROM		
Operations		
Net earnings	**$1,533,155**	$ 995,389
Items not requiring working capital	**1,093,249**	684,517
	2,626,404	1,679,906
Long-term debt	**1,375,000**	—
Issue of common shares for cash, net of share issue expenses (note 5)	**670,481**	842,197
	4,671,885	$2,522,103
WORKING CAPITAL APPLIED TO		
Fixed assets, net (note 2)	**5,459,284**	4,285,018
DECREASE IN WORKING CAPITAL POSITION	**(787,399)**	(1,762,915)
WORKING CAPITAL DEFICIENCY AT BEGINNING OF YEAR	**(1,904,073)**	(141,158)
WORKING CAPITAL DEFICIENCY AT END OF YEAR	**$(2,691,472)**	$(1,904,073)

AUDITORS' REPORT

To the Shareholders of
Czar Resources Ltd.

We have examined the consolidated balance sheet of Czar Resources Ltd. as at October 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
February 16, 1979

Thorne Riddell & Co.
Chartered Accountants

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED OCTOBER 31, 1978

NOTE 1 ACCOUNTING POLICIES

a) Principles of Consolidation

The consolidated financial statements include the accounts of Czar Resources Ltd. and its wholly-owned subsidiaries, Czar Developments Ltd. and Czar Resources, Inc.

b) Foreign Currency Translation

The accounts of the foreign subsidiary are translated to Canadian dollars on the following basis:

(i) Current assets and current liabilities, at the rate of exchange in effect as at the balance sheet date;

(ii) Fixed assets, at the rate of exchange in effect at the date on which the respective assets were acquired;

(iii) Revenues and expenses (excluding depreciation and depletion which are translated at the same rate as the related assets), at the average rate of exchange for the year.

c) Petroleum and Natural Gas Operations

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized. Costs include land acquisition costs, geological and geophysical expense, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, and related overhead expenses. Such costs are depleted using the composite unit of production method based upon estimated proven developed reserves. In calculating depletion, natural gas reserves are converted to equivalent barrels of crude oil based on the relative net sales value of each product.

All of the Company's exploration and production activities related to petroleum and natural gas are conducted with others and accordingly, the accounts reflect only the Company's proportionate interest in such activities.

Reference is made to note 2.

d) Depreciation

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the composite unit of production method based on estimated proven developed reserves. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

e) Income Taxes

The Company follows the tax allocation method of accounting under which the income tax provision is based on the earnings reported in its accounts. Under this method, the Company provides for deferred income taxes to the extent that income taxes otherwise payable are reduced by claiming exploration and development costs and capital cost allowances in excess of the related depletion and depreciation provisions reflected in its accounts.

NOTE 2 DRILLING PROGRAM AGREEMENTS

The Company has entered into drilling agreements with certain limited partnerships ("partnerships") under which the partnerships have the right to acquire a working interest, on a prospect-by-prospect basis, in substantially all the Company's undeveloped properties. Such rights are exercisable upon execution of the prospect agreement, upon payment of an initial consideration, and agreement to pay the Company fixed instalments over a period approximating 26 years. Interest on the unpaid purchase price is calculated with reference to a fixed percentage of net revenue from the wells drilled pursuant to the drilling agreements (less the unpaid instalments on the purchase price). The Company holds the respective partnerships' interest in the prospects in trust and has the right to obtain mortgage security on the prospects to secure the instalment amounts and applicable interest. Under the terms of the drilling agreements, the partnerships pay for all geological, geophysical and intangible costs of drilling. The Company is essentially responsible for well equipment and related production facility costs. In addition the Company retains a net revenue interest in the related properties and earns a management fee for services rendered to the partnerships.

Under the Company's accounting policies all expenditures incurred by the Company pursuant to the drilling agreements, net of recoveries from the partnerships and net of payments of initial consideration for disposition of properties, are recorded as additions to fixed assets. Management fees charged by the Company are credited to earnings. Instalment amounts for property interests disposed of, as noted above, total $43,501,900 at October 31, 1978 and will be recorded in the accounts of the Company as and when received.

NOTE 3 BANK INDEBTEDNESS

Bank indebtedness is secured by accounts receivable and certain petroleum and natural gas properties.

NOTE 4 LONG-TERM DEBT

Long-term debt is comprised of a bank production loan which bears interest at 1½% over a Canadian chartered bank's prime lending rate and is secured by an assignment of accounts receivable and certain petroleum and natural gas properties.

Estimated principal repayments of the bank production loan for the next four years are as follows: 1979—$500,000; 1980—$500,000; 1981—$500,000 and 1982—$375,000.

NOTE 5 CAPITAL STOCK

(a) Changes in the Company's capital stock for the year ended October 31, 1978 were as follows:

	Number of Shares	Consideration
Balance, October 31, 1977	2,278,400	$1,980,875
Issued pursuant to a 3 for 1 stock split	4,556,800	—
Issued for cash less applicable share issue expenses of $14,579	150,000	547,921
Issued for cash pursuant to option agreements to purchase common shares	137,400	122,560
Balance, October 31, 1978	7,122,600	$2,651,356

(b) At October 31, 1978, directors, officers and employees held options to purchase 354,330 common shares of the Company at prices ranging from $.48 to $6.67 per share. Such options are exerciseable from time to time to October, 1981.

(c) At October 31, 1978 the Company had agreements to issue 22,500 common shares, at an issue price of $4.17 per share, to employees.

(d) During the year, the authorized capital was increased to 10,000,000 common shares without nominal or par value which may be issued for a maximum consideration of $20,000,000.

NOTE 6 EARNINGS PER SHARE

Earnings per share have been computed using the weighted average number of shares outstanding during the year. The earnings per share for 1977 have been restated to reflect the three for one stock split referred to in note 5 (a). The effect of all stock options and agreements to issue common shares which were outstanding at October 31, 1978 is not material on the earnings per share calculations.

NOTE 7 COMMITMENTS

Lease commitments in respect of office premises are $117,200 for each of the next five years, commencing March 1, 1979.

The Company has contracted for the use of a drilling rig for a period of two years from November 1, 1978. Minimum annual rental charges under terms of the contract are $1,377,000.

NOTE 8 STATUTORY INFORMATION

During the year, the Company paid remuneration of $189,051 to its senior officers (including the five highest paid employees). The Company paid no remuneration to its four directors in their capacity as directors. Three of the directors are also officers of the Company.

NOTE 9 RECLASSIFICATION OF 1977 ACCOUNTS

Certain 1977 amounts have been reclassified to conform with the financial statement presentation adopted for 1978.

NOTE 10 SUBSEQUENT EVENTS

(a) Subsequent to October 31, 1978, the Company entered into other drilling agreements with limited partnerships. Terms and conditions of the drilling agreements are similar to those outlined in note 2.

(b) Subsequent to October 31, 1978, the Company sold, at approximate cost, its interest in a natural gas pipeline for $824,000.

ABBREVIATIONS

Throughout this report standard oil and gas abbreviations have been used. Their explanation is as follows:

AOF	Absolute Open Flow
Bcf	Billion Cubic Feet
BOPD	Barrels of Oil Per Day
LPG	Liquified Petroleum Gas
Mcf	Thousand Cubic Feet
MMcf	Million Cubic Feet

CZAR RESOURCES LTD.
ANNUAL REPORT 1978

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McAra PRINTING
Calgary Alberta Canada